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Estate Tax Repeal and the Budget Process

**Karen C. Burke
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ESTATE TAX REPEAL AND THE BUDGET PROCESS

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Grayson M.P. McCouch^{††}

I. Introduction

The centerpiece of the Bush Administration's current budget proposal is a permanent extension of nearly all of the expiring tax cuts enacted in 2001 and 2003.¹ Under this proposal, the federal estate and generation-skipping transfer taxes would expire in 2010, and would no longer be reinstated in 2011 as provided in the 2001 Act.² Moreover, property passing from a decedent in 2010 and subsequent years would not receive a basis equal to fair market value but instead would take a carryover basis, albeit with generous exemptions that would continue to allow a tax-free step-up for most appreciated property owned at death.³ Notwithstanding permanent repeal of the estate and

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¹ See Office of Mgmt. & Budget, Budget of the U.S. Government, Fiscal Year 2005: Analytical Perspectives (2004) [hereinafter 2005 Budget Proposal]; Staff of Joint Comm. on Taxation, Description of Revenue Provisions Contained in the President's Fiscal Year 2005 Budget Proposal 10 (2004) (JCS-3-04) [hereinafter Joint Committee Description]. The proposed extension applies to the 2001 tax cuts that would otherwise expire at the end of 2010, as well as the 2003 tax cuts that would otherwise expire at the end of 2005 and 2008. However, the AMT relief provisions, which are scheduled to expire at the end of 2004, would be extended for only one year. *Id.* at 9-10.

² See Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 [hereinafter 2001 Act], § 501(a) (repealing estate tax for decedents dying after 2009), § 501(b) (repealing GST tax for transfers occurring after 2009), § 901(a) (sunset of 2001 Act provisions for 2011 and subsequent years), §901(b) (reinstating prior law for 2011 and subsequent years "as if [the 2001 Act] had never been enacted").

³ See 2001 Act, *supra* note 2, § 541 (terminating fair-market-value basis for property acquired from a decedent after 2009), § 542 (introducing carryover basis for property acquired from a decedent after 2009). For a discussion of the 2001 Act's carryover basis provisions, see Burke & McCouch, Estate Tax Repeal: Through the

generation-skipping transfer taxes, lifetime gifts in excess of \$1,000,000 would remain subject to gift tax at a flat 35% rate.⁴

Although the Administration's proposal also contains significant additional tax cuts, the bulk of the revenue loss in the near term is attributable to repeal of the sunset provisions of the 2001 and 2003 Acts. According to Congressional Budget Office (CBO) projections, the Administration's proposal would lose \$1.3 trillion of revenue during fiscal years 2005-2014. Sunset repeal accounts for \$1.1 trillion (85%) of the revenue loss, and this amount is heavily concentrated in years outside the five-year budget window, thereby masking the cost of the Administration's proposal.⁵ Moreover, the Administration's proposal comes at a time of mounting fiscal strain. Only three years ago, the CBO's ten-year projections showed a unified budget surplus of \$5.6 trillion; today, the projections show a budget deficit of just over \$2 trillion, even without taking the Administration's proposal into account.⁶

This article examines the Administration's proposal to make estate tax repeal permanent. It focuses on the budgetary impact of the proposal, the procedural obstacles to repeal of the sunset provisions, and the prospects for a durable compromise solution.

II. Baselines, Windows, and Budget Projections

Ironically, the reappearance of large and persistent deficits coincided with the expiration, on

Looking Glass, 22 Va. Tax Rev. 187 (2002).

⁴ See 2001 Act, *supra* note 2, § 511(d) (imposing new gift tax rate schedule for gifts made after 2009).

⁵ See Cong. Budget Office, Analysis of the President's Budgetary Proposals for Fiscal Year 2005, at 4 (Mar. 2004) [hereinafter CBO Analysis]. According to the CBO projections, \$949 billion, representing more than 86% of the \$1.1 trillion revenue loss attributable to sunset repeal, falls in fiscal years 2011-2014.

⁶ See Cong. Budget Office, The Budget and Economic Outlook: Fiscal Years 2002-2011, at 2 tbl.1-1 (Jan. 2001); CBO Analysis, *supra* note 5, at 2 tbl.1-1.

September 30, 2002, of major budget enforcement procedures consisting of caps on discretionary spending and pay-as-you-go (PAYGO) offset rules for new mandatory spending and revenue legislation.⁷ Although the statutory PAYGO rules played an important role in controlling deficits during the 1990's, their effectiveness began to erode with the appearance of surpluses beginning in 1998. The 2001 Act and other new legislation gave rise to significant costs in the form of increased spending and reduced revenues, without offsetting savings.⁸ At the same time, Congress bypassed PAYGO's mandatory sequestration requirement simply by directing the Office of Management and Budget (OMB) to reset the PAYGO scorecard to zero, a technique known as "directed scorekeeping."⁹ Thus, at the end of 2002, Congress purged the PAYGO scorecard for fiscal years 2001-2006 of positive balances totalling more than \$700 billion, representing mainly revenue losses attributable to the 2001 Act.¹⁰ By obliterating these positive balances, Congress avoided the threat of mandatory sequestration

⁷ These procedures, originally enacted in the Budget Enforcement Act of 1990, Pub. L. No. 101-508, tit. XIII, 104 Stat. 1388-573, replaced the Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, tit. II, 99 Stat. 1037 (better known as Gramm-Rudman-Hollings). In contrast to Gramm-Rudman-Hollings, which sought to achieve specific levels of deficit reduction, the Budget Enforcement Act attempted to control the growth of deficits due to new legislation. For an analysis of Gramm-Rudman-Hollings, see Stith, *Rewriting the Fiscal Constitution: The Case of Gramm-Rudman-Hollings*, 76 Cal. L. Rev. 593 (1988).

⁸ While some observers argued that the PAYGO requirements did not apply if new mandatory spending or tax laws did not cause (or increase) a deficit, the official PAYGO scoring mechanism continued to be maintained after the appearance of surpluses. *See* Cong. Budget Office, *The Budget and Economic Outlook: Fiscal Years 2004-2013*, at 111-12 (Jan. 2003); *see also* Saturno, *The Budget Enforcement Act: Its Operation Under a Budget Surplus* (Cong. Res. Serv., Feb. 11, 1998) (noting that PAYGO rules required that any increase in mandatory spending or decrease in revenue from new legislation would have to be fully offset, even in a time of budget surplus).

⁹ *See* Block, *Pathologies at the Intersection of the Budget and Tax Legislative Processes*, 43 B.C. L. Rev. 863, 897-98 (2002) (describing use of directed scorekeeping to avoid sequestration and noting that Congress "got its tax cuts without ever having to pay for them").

¹⁰ *See* Pub. L. No. 107-312; Cong. Budget Office, *The Budget and Economic Outlook: Fiscal Years 2004-2013*, at 116-17 & tbl.A-3 (Jan. 2003). This amount included lost revenue attributable to the estate and gift tax provisions of the 2001 Act through fiscal year 2006. *See* U.S. General Accounting Office, *Budget Issues: Budget Enforcement Compliance Report*, Appendix II at 31 tbl.14 (June 2002) (comparing OMB projections showing nearly \$43.5 billion of lost revenue due to these provisions with CBO projections showing nearly \$25 billion for the same period).

as a result of legislation enacted before the end of fiscal year 2002.

The statutory PAYGO rules were still in force when Congress enacted the 2001 tax cuts. By including a sunset provision that terminates those tax cuts and restores prior law in 2011, Congress brought virtually all of the projected cost of estate tax repeal within the 10-year budget window and enabled the 2001 Act to avoid a procedural challenge under the Senate's budget rules.¹¹ Moreover, because the CBO budget baseline assumes that "present laws continue without change," the baseline projections are predicated on the assumption that the estate tax will expire at the beginning of 2010 and then be fully reinstated in 2011.¹² As a result, virtually all of the revenue losses from the 2001 Act have already been taken into account for purposes of budget scorekeeping, and the additional revenue losses shown in current budget projections are attributable to the Administration's proposal to repeal the sunset provision.¹³

Interestingly, the budget window for the Administration's fiscal year 2005 proposal has been shortened from 10 years to five years, thereby minimizing the projected cost of permanent estate tax repeal for purposes of budget scorekeeping. The cost of extending the estate tax repeal beyond 2010

¹¹ The conference agreement shortened the phase-in period for estate tax repeal by one year and imposed the sunset provision in 2011. These changes were necessary to avoid net revenue losses beyond the 10-year budget window, which would have been subject to a point of order under the Byrd rule. The conference agreement passed the Senate by a 58-33 vote, two votes short of the 60 votes that would have been needed to waive the Byrd rule. *See* Burke & McCouch, *supra* note 3, at 188 n.4, 193 n.27.

¹² Cong. Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005-2014*, at 5 (Jan. 2004). The CBO's assumption, while "thoroughly unrealistic," is "fully consistent" with the purpose of the baseline; indeed, any attempt to incorporate future legislative changes would undermine the baseline's usefulness as a benchmark for measuring the effect of proposed changes. *See* Burke & McCouch, *supra* note 3, at 193 n.25.

¹³ The Joint Committee on Taxation estimated revenue losses of over \$133 billion from the estate and gift tax cuts in the 2001 Act for fiscal years 2002-2011. *See* Joint Comm. on Taxation, *Estimated Budget Effects of the Conference Agreement for H.R. 1836*, at 3 (May 26, 2001) (JCX-51-01).

(or, more precisely, of repealing the sunset provision) is relatively trivial during fiscal years 2005-2009,¹⁴ but the projected revenue losses rise sharply in years outside the five-year budget window. According to CBO projections, permanent estate tax repeal will cost around \$206 billion in revenue losses during fiscal years 2005-2014, and more than 95% of this amount falls in the years outside the five-year budget window.¹⁵ By 2014, the CBO projections show annual revenue losses of more than \$60 billion from the proposal to make estate tax repeal permanent.

Predictably, the costs of permanent estate tax repeal rise dramatically with each passing year under a 10-year horizon that includes years after fiscal year 2011. In 2002, the projected cost of permanent estate tax repeal amounted to just over \$99 billion in additional revenue losses for fiscal years 2003-2012;¹⁶ by 2004, the revised 10-year projection for fiscal years 2005-2014 more than doubled, reaching nearly \$206 billion.¹⁷ The additional revenue cost reflects the substitution of two fiscal years (2013 and 2014) of forgone estate tax revenue at the end of the moving 10-year horizon for two fiscal years (2003 and 2004) of undiminished revenue at the beginning of the horizon. Thus, the fiscal (and political) stakes of permanent estate tax repeal are likely to become higher as the original

¹⁴ Nonetheless, revenue estimates reflect behavioral effects induced by a proposed change in present law. Repeal of the sunset provision in the 2001 Act would encourage individuals to retain property until death and avoid making taxable lifetime gifts. This behavioral change appears to account for the CBO's projection of \$7 billion in lost revenue for fiscal years 2005-2009 attributable to extending estate tax repeal after 2010. *See* CBO Analysis, *supra* note 5, at 11 tbl.1-6.

¹⁵ *See id.* Indeed, more than 80% of the revenue losses fall in the last three years of the 10-year period.

¹⁶ *See* Joint Comm. on Taxation, Estimated Revenue Effects of H.R. 2143, "Permanent Death Tax Repeal Act of 2001" (June 4, 2002) (JCX-50-02). In projecting the effects of proposed tax legislation, the CBO relies on revenue estimates provided by the Joint Committee on Taxation.

¹⁷ *See* Joint Comm. on Taxation, Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2005 Budget Proposal (Mar. 3, 2004) (JCX-14-04R).

sunset date draws nearer.

Furthermore, the cost of permanent repeal may be significantly understated due to factors not reflected in the assumptions underlying the budget projections. On its face, the Administration's proposal would make estate tax repeal permanent but would leave the gift tax in place as well as the carryover basis rules for property passing at death. However, the compromise struck in the 2001 Act appears to be politically unstable. It seems unlikely that a stand-alone gift tax, with all its administrative costs and compliance problems, would long survive in the absence of the estate tax.¹⁸ Similarly, the version of carryover basis enacted in the 2001 Act has serious technical and administrative flaws which threaten to undermine its viability in the long term.¹⁹ Indeed, given the complexity of the carryover basis rules, the lack of enforcement mechanisms, and the negligible amount of revenue likely to be raised, it would hardly be surprising to see carryover basis abolished even before it comes into force in 2010. If both the gift tax and carryover basis were to disappear along with the estate tax, leaving an unlimited step-up in basis for appreciated property passing at death, the resulting revenue loss would dwarf the projected costs of the Administration's current proposal.

Since budget projections take into account only annual cash-flow revenue effects within a specified budget window, long-term costs are likely to be distorted or omitted altogether.²⁰ A realistic assessment of alternative tax proposals would require a present value analysis of future costs in order to

¹⁸ For a discussion of the problems of a stand-alone gift tax, see Burke & McCouch, *supra* note 3, at 223-28; *see also id.* at 227 (suggesting that retention of the gift tax may represent "merely a tactical measure" to disguise the impact of estate tax repeal and disarm critics).

¹⁹ *See id.* at 201-23.

²⁰ *See* Graetz, Paint-By-Numbers Tax Lawmaking, 95 Colum. L. Rev. 609, 673 (1995) (noting "potential aberrations from accounting for revenues on an annual cash-flow basis within a specified budget period").

permit a meaningful comparison of proposals with different cash flows.²¹ Given the deteriorating fiscal outlook, such comparisons may become increasingly important in determining whether the tax cuts enacted in 2001 and 2003 will become permanent and, if so, what combinations of spending reductions and tax increases can be used to pay for them.²² For example, one of the most pressing problems not squarely addressed in the Administration's current budget proposal is the need for permanent reform of the alternative minimum tax (AMT), which in its present form threatens to eliminate nearly 40% of the benefits of the 2001 and 2003 income tax cuts by 2014.²³ In 2014, the projected cost of estate tax repeal will exceed the cost of modest AMT reforms that are widely viewed as politically unavoidable.²⁴

When it was enacted, the 2001 Act was perceived as setting a new standard for budget gimmickry.²⁵ Nevertheless, the Administration's current proposal goes even further.²⁶ Under this proposal, for purposes of determining the impact of budget legislation under the Budget Enforcement

²¹ See *id.* at 676-77; *id.* at 677 (noting that “[w]hatever the scorekeeping rules, . . . opportunistic and creative legislators and their staff will work within and around them, structuring proposals to maximize the likelihood of outcomes they desire”).

²² By one estimate, over a 75-year period, the cost of permanent estate tax repeal would amount to nearly 40% of the entire projected shortfall in the Social Security trust funds over the same period. See Friedman & Lee, Estate Tax Repeal Would Be Costly, Yet Benefit Only a Few, Tax Notes 1984, 1987 (June 24, 2002).

²³ See Gale & Orszag, Should the President's Tax Cuts Be Made Permanent?, Tax Notes 1277, 1282 (March 8, 2004). The Administration's current budget proposal extends for one year the existing AMT exemption and the use of nonrefundable credits to offset AMT liability. Those relief provisions would expire at the end of 2005 and, by 2014, the number of AMT taxpayers would increase to 44 million under the Administration's proposal. See *id.*

²⁴ See *id.* tbl.2 (showing \$51 billion cost of modest AMT reform for 2014).

²⁵ See Friedman et al., New Tax-Cut Law Ultimately Costs as Much as Bush Plan: Gimmicks Used to Camouflage \$4.1 Trillion Cost in Second Decade 2 (Center on Budget and Policy Priorities, June 27, 2001) (describing 2001 Act as having “more budget gimmicks than any tax bill – and quite possibly any piece of major legislation – in recent history”).

²⁶ Greenstein & Friedman, Budget Rule Change Would Make the Cost of Extending the Tax Cuts Disappear 2 (Center on Budget and Policy Priorities, Feb. 27, 2004) (describing proposal as “one of the largest and most flagrant budget gimmicks in recent memory”).

Act, the budget baseline would be revised to assume permanent extension of all of the expiring tax provisions of the 2001 Act (and unspecified provisions of the 2003 Act).²⁷ Thus, the proposal would prevent the cost of repealing the sunsets from ever being scored. This sort of bait-and-switch tactic – first imposing a sunset provision to avoid the appearance of long-term deficits, and then changing the baseline to avoid the impact of the sunset provision – is neither fiscally nor politically defensible. At the very least, it illustrates the need to reinstate the PAYGO rules or similar procedural constraints to enforce a measure of budget discipline.²⁸

III. Reconciliation, Sunsets, and the Byrd Rule

The sunset provisions of the 2001 Act reflect the close relationship between the budget reconciliation process authorized by the Congressional Budget Act and the Senate’s “Byrd rule.”²⁹ Under the Byrd rule, any senator may raise a point of order, which can be waived only by a three-fifths vote, against the inclusion of “extraneous” matter in a reconciliation bill.³⁰ Extraneous matter, as defined

²⁷ See 2005 Budget Proposal, *supra* note 1, at 217. The Administration defends the proposed change to the budget baseline on the ground that the expiring tax cuts “were clearly not intended to be temporary.” *Id.* This statement ignores the fact that the 2001 and 2003 tax cuts could not have been enacted as permanent measures because they lacked the necessary supermajority to waive a procedural challenge under the Senate rules. See *infra* notes 30-32 and accompanying text.

²⁸ Indeed, the Senate budget resolution for fiscal year 2005 restores a procedural point of order for failure to offset revenue losses within an extended 10-year budget window. See *infra* note 59 and accompanying text. By contrast, the Administration proposal would apply PAYGO requirements to new mandatory spending but not to tax cuts. See 2005 Budget Proposal, *supra* note 1, at 216.

²⁹ See Evans, The Budget Process and the “Sunset” Provision of the 2001 Tax Law, Tax Notes 405, 414 (Apr. 21, 2003) (arguing that the sunset provisions in the 2001 Act “reflected the inextricable connection between the budget reconciliation process and the Byrd rule”). The reconciliation process is authorized by the Congressional Budget Act of 1974, Pub. L. 93-344, tit. I-IX, 88 Stat. 297 (authorizing reconciliation process). The Byrd rule appears at § 313 of the Congressional Budget Act (codified at 2 U.S.C. § 644). For the history and operation of the Byrd rule, see Keith, The Budget Reconciliation Process: The Senate’s “Byrd Rule” (Cong. Res. Serv., Feb. 19, 2004).

³⁰ See Congressional Budget Act of 1974, *supra* note 29, § 313(a). As defined in § 313(b), “extraneous” is a term of art that can give rise to numerous complexities. See Keith, *supra* note 29, at 5-7; Schick, The Federal Budget:

in the statute, includes any provision that would increase the deficit for a fiscal year outside the budget window covered by the reconciliation measure.³¹ As a practical matter, application of the Byrd rule would have required 60 votes to enact permanent estate tax repeal as part of the reconciliation process in 2001.³² Unwilling to accept smaller, permanent tax cuts but lacking a 60-vote supermajority in the Senate, proponents of the tax cuts agreed to the sunset provision in the conference committee, hoping to repeal the sunset provision as soon as possible. Against this backdrop, the 2001 Act raises questions specifically concerning the implications of the Byrd rule for estate tax repeal and more generally concerning the effect of the reconciliation process on tax legislation.

The reconciliation process has been an integral component of every major deficit reduction measure since it was first used in 1980.³³ Reconciliation is an optional process that is initiated by a concurrent budget resolution adopted by the House and Senate with reconciliation instructions directing specified revenue and spending changes.³⁴ The proposed legislative changes are then consolidated in a

Politics, Policy, Process 128 (rev. ed. 2000).

³¹ Congressional Budget Act of 1974, *supra* note 29, § 313(b)(1)(E).

³² *See* Evans, *supra* note 29, at 414. Alternatively, if the 2001 tax bill had been introduced outside the reconciliation process, the bill would have been subject to a filibuster under the Senate's regular rules, requiring 60 votes for cloture. *See id.*

³³ Under the Congressional Budget Act, reconciliation is "the procedure Congress uses to bring revenue and direct spending under existing laws into conformity with the levels set in the budget resolution." Schick, *supra* note 30, at 125. Although the reconciliation process was originally intended as a procedure for reconciling differences between a first and second budget resolution in a particular year, it eventually evolved into a process for reconciling the first (and only) budget resolution with the legislation needed to achieve the overall revenue and spending changes. *See* Tobin, *Less is More: A Move Toward Sanity in the Budget Process*, 16 St. Louis U. Pub. L. Rev. 115, 130 (1996); Evans, *supra* note 29, at 406.

³⁴ Reconciliation instructions direct the designated committees to recommend legislation to achieve specific dollar changes in existing revenue or direct spending laws; legislative changes are then compiled by the budget committee in each house in one or more reconciliation bills. *See* Schick, *supra* note 30, at 125-28.

reconciliation package and considered under a fast-track procedure, with strictly limited opportunities for debate and amendment.³⁵ Most importantly, reconciliation bills are protected from the Senate's normal filibuster rules and thus require only a simple majority vote for passage.³⁶ In exchange for these procedural protections, reconciliation bills are limited in scope and generally cannot include extraneous matter. Specifically, the Byrd rule prohibits use of the reconciliation process to increase net outlays or reduce net revenues for fiscal years outside the specified budget window (generally extending for five or 10 fiscal years).³⁷

With the advent of budget surpluses in the late 1990's, increased pressure to use the reconciliation process for tax cutting measures produced a sharp division in the Senate. Supporters of budget discipline argued that the reconciliation process should be available only for revenue-neutral or deficit-reducing legislation, while supporters of large-scale tax cuts maintained that the process was equally available for revenue-reducing legislation.³⁸ In the negotiations leading up to the 2001 Act, the

³⁵ For example, Senate debate on reconciliation bills is limited to no more than 20 hours. Congressional Budget Act of 1974, *supra* note 29, § 310(e)(2). In addition, amendments must be "germane" and generally must be deficit neutral. *Id.*, §§ 305(b)(2), 310(d)(2). *See* Tobin, *supra* note 33, at 131 (arguing that the 20-hour limit made more sense when reconciliation was intended merely to reconcile differences between two budget resolutions in the same year).

³⁶ *See* Evans, *supra* note 29, at 407. The Byrd rule applies only in the Senate. Procedural rules are generally much less important in the House, since the House majority can and does freely waive budget rules. *See* Schick, *supra* note 30, at 128, 134-37.

³⁷ Some senators viewed the Byrd rule as necessary to protect the Senate's deliberative character and to prevent the reconciliation process from being used to circumvent the Senate's filibuster rules. *See* Tobin, *supra* note 33, at 132 ("The general view in the Senate was that deficit reduction was so important that it warranted fast-track consideration. However, Senators wanted to make sure that this privileged procedure was applied only to measures which would decrease the deficit."); Evans, *supra* note 29, at 408.

³⁸ *See* Evans, *supra* note 29, at 410-12 (describing Congressional skirmishing over the Byrd rule between 1995 and 2000); Schick, *supra* note 30, at 128-29 (concluding that the reconciliation process can be used "to either raise or cut taxes and spending").

procedural issue remained controversial: It was settled in the Senate that the reconciliation process could be used for measures that reduced taxes, but that such measures would violate the Byrd rule unless the tax cuts were offset or subject to sunset at the end of the budget window.³⁹ Proponents of the 2001 tax cuts grudgingly agreed to impose a sunset provision at the end of the 10-year budget window, gambling that they would be able to achieve permanent estate tax repeal at a later date.⁴⁰ Although the deteriorating fiscal situation since 2001 has made that gamble appear increasingly risky, the sunset provisions certainly were not included as the result of a “mistake or trick.”⁴¹

Legislation seeking to make estate tax repeal permanent has repeatedly been introduced since enactment of the 2001 Act, but has proved abortive.⁴² In his State of the Union address in January 2004, President Bush warned that if Congress does not repeal the sunset provision “the death tax will eventually come back to life” and “Americans [will] face a tax increase.”⁴³ Of course, it is quite misleading to suggest that the tax cuts enacted in 2001 and 2003 were even presumptively permanent; neither the 2001 Act nor the 2003 Act could have passed in the Senate without the sunset provisions

³⁹ See Evans, *supra* note 29, at 414.

⁴⁰ The debate over the application of the Byrd rule ended anticlimactically when the sunset provision was added in the conference agreement with “little or no further controversy.” *Id.*

⁴¹ *Id.* at 405.

⁴² See, e.g., Tax Relief Guarantee Act of 2002, H.R. 586, 107th Cong.; Permanent Death Tax Repeal Act of 2002, H.R. 2143, 107th Cong.; Death Tax Repeal Permanency Act of 2003, H.R. 8, 108th Cong.; Permanent Death Tax Repeal Act of 2003, H.R. 139, 108th Cong.; Death Tax Permanency Act of 2003, H.R. 57, 108th Cong.; Family Heritage Preservation Act, H.R. 51, 108th Cong.; Permanent Death Tax Repeal Act of 2003, S. 169, 108th Cong.; Death Tax Fairness Act of 2003, S. 13, 108th Cong.

⁴³ Address Before a Joint Session of the Congress on the State of the Union, 40 Weekly Comp. Pres. Doc. 94, 98 (Jan. 20, 2004); *id.* (“What Congress has given, the Congress should not take away.”)

that explicitly made them temporary.⁴⁴ Proponents of estate tax repeal may attempt to dismiss the Byrd rule as an “arcane budget rule” or a mere “technicality,” suggesting that such procedural constraints are somehow inappropriate.⁴⁵ And this impression may be reinforced by simplistic and self-serving assertions equating failure to repeal the sunset provisions with enactment of a tax increase. Ultimately, such rhetoric can only aggravate a sense of public confusion and frustration with a budget process so complex and opaque that it has become largely unintelligible to ordinary legislators, lawyers, and citizens.⁴⁶

The controversy over the Byrd rule and permanent estate tax repeal remains very much alive, as illustrated by the political wrangling over a concurrent budget resolution for fiscal year 2005. Budget resolutions, like reconciliation bills, receive expedited treatment and immunity from filibuster in the Senate. These procedural features have contributed to turn budget resolutions into partisan platforms for promoting the majority party’s budgetary agenda.⁴⁷ Since budget resolutions are generally passed by straight party-line votes and require only a bare majority in each house, they often involve only

⁴⁴ The Byrd rule also played a role in formulating the reconciliation directives in the budget resolution that led to the 2003 Act. Ultimately, the revenue reductions in the 2003 Act were limited to \$350 billion, consistent with an agreement between Senator Grassley, chairman of the Senate Finance Committee, and other senators. *See* Keith, Revenue Reconciliation Directives in the FY 2004 Budget Resolution 5-7 (Cong. Res. Serv., May 7, 2003); Taylor, Concessions to Moderates Imperil Early GOP Tax Cutting Accord, 61 CQ Weekly 866 (April 12, 2003).

⁴⁵ *See* Evans, *supra* note 29, at 411 (quoting Senators Roth and Gramm in a 1999 floor debate over application of the Byrd rule to tax-cutting legislation).

⁴⁶ *See* Garrett, Rethinking the Structures of Decisionmaking in the Federal Budget Process, 35 Harv. J. on Legis. 387, 429 (1998) (noting that complex budget enforcement rules may cause voters to become “more disillusioned” with Congress).

⁴⁷ The budget resolution sets forth aggregate levels for discretionary spending, entitlement spending, and revenues. *See* Tobin, *supra* note 33, at 128.

minimal input from the minority party.⁴⁸ Once a concurrent budget resolution has been agreed upon and transformed into a reconciliation package, however, the budget process greatly enhances the likelihood that such legislation will ultimately be enacted with little or no substantive change.⁴⁹ Indeed, it is hardly an exaggeration to say that the budget process creates a “legislative system in which majorities can adopt and enforce any budget policy they prefer, provided only that a majority can agree on a policy and agree to enforce it.”⁵⁰

The efforts to adopt a budget resolution for fiscal year 2005, embodying the Administration’s budget proposal, illustrate both the opportunities and the pitfalls of majoritarian budget politics. In March 2004, the House and Senate passed separate budget resolutions containing reconciliation instructions.⁵¹ While the House resolution reconciled tax cuts sufficient to accommodate the Administration’s proposal, the Senate resolution reconciled only \$80.6 billion of tax cuts for fiscal years 2005-2009.⁵² The Senate resolution assumed that the reconciled tax cuts would be used to extend

⁴⁸ *See id.* at 139.

⁴⁹ *See* Schick, *supra* note 30, at 128 (noting that “there is a strong probability that a reconciliation bill will pass once it is initiated”).

⁵⁰ Gilmour, *Reconcilable Differences? Congress, the Budget Process, and the Deficit* 85 (1990).

⁵¹ *See* S. Con. Res. 95, 108th Cong. (2004); H. Con. Res. 393, 108th Cong. (2004); Heniff, *Congressional Budget Actions in 2004*, at 9-10 (Cong. Res. Serv., March 31, 2004).

three “middle class” tax cuts and to accelerate estate tax repeal by one year (from 2010 to 2009).⁵³

The specific policy assumptions contained in the Senate resolution are nonbinding, however, since only the aggregate amounts are enforceable through points of order.⁵⁴

The juxtaposition of accelerated estate tax repeal with extension of the three middle class tax cuts is revealing. While the distributional impact of the middle class tax cuts is spread relatively evenly, the benefits of estate tax repeal are sharply skewed toward the very top of the income and wealth distribution – by 2009, the estate tax will reach only estates worth more than \$3.5 million.⁵⁵ Moreover, extending the middle class tax breaks may be sufficiently popular to be enacted without resort to the reconciliation process.⁵⁶ Although the acceleration proposal has not been officially explained or described in any detail, it appears to leave the original sunset provision in place, with the result that the estate tax would still spring back into force in 2011. By avoiding revenue losses outside the five-year

⁵² The Senate resolution directed the Finance Committee to report legislation reducing revenues by the specified amount over fiscal years 2005-2009. S. Con. Res. 95, 108th Cong., § 201(a) (2004).

⁵³ The three middle class tax cuts (the \$1,000 child tax credit, marriage penalty relief, and the expanded 10% bracket) were enacted in 2001 subject to a phase-in period. The 2003 Act accelerated full implementation of these cuts to 2003, but the acceleration expires at the end of 2004, leaving the original phase-in schedule in place. In effect, these three tax cuts “sunset twice – once in 2004 and again in 2010.” Gale & Orszag, *supra* note 23, at 1280-81.

⁵⁴ See Garrett, *The Congressional Budget Process: Strengthening the Party-in-Government*, 100 *Colum. L. Rev.* 702, 720 (2000).

⁵⁵ On the distribution of the three middle class tax breaks, see Shapiro & Friedman, *Tax Returns: A Comprehensive Assessment of the Bush Administration Tax Cuts 20-22* (Center on Budget and Policy Priorities, April 2004) (noting that these tax breaks also provide significant benefits to high-income households). On the distribution of the benefits of estate tax repeal, see Gale & Potter, *An Economic Evaluation of the Economic Growth and Tax Relief Reconciliation Act of 2001*, 55 *Nat'l Tax J.* 133, 147 (2002) (noting disproportionate benefits for the top 1% of the income distribution).

⁵⁶ Thus, the reconciled amount originally intended for middle class tax cuts might eventually be used for less popular tax cuts in a reconciliation bill. Indeed, the reason for sunsetting the acceleration of the middle class tax cuts in the 2003 Act was presumably to make room for other tax cuts, such as reduced rates for capital gains and qualified dividend income.

budget window, the proposal to accelerate estate tax repeal (rather than make it permanent) is presumably intended to preclude a challenge under the Byrd rule. Some observers may view the acceleration proposal as a face-saving gesture reflecting a concession that the Administration's proposal for permanent repeal was unrealistic. Others may view the acceleration proposal more cynically as a preemptive strike to ward off the possibility of a stable compromise solution involving permanent retention of the estate tax with lower rates and a higher exemption.⁵⁷

Following the passage of separate budget resolutions in each house, negotiations over a concurrent budget resolution appear to have reached an impasse.⁵⁸ The deadlock stems from the strict PAYGO rule which was added to the Senate budget resolution by a floor amendment with support from several moderate Republican senators who broke ranks to vote with the Democratic minority.⁵⁹ In effect, this point of order would require that tax cuts be offset during the five-year budget window and the five years thereafter, unless waived by a three-fifths vote in the Senate. The leadership's inability or unwillingness to come up with an alternative proposal acceptable to these moderate Republican senators illustrates the risk that even a majoritarian budget process may come to a standstill if compromise would "diminish future electoral prospects by reducing issue advantages."⁶⁰ Failure to reach agreement on a budget resolution is unusual (though by no means unprecedented), and the

⁵⁷ Of course, this tactic might backfire if Congress were forced to confront the problems of implementing carryover basis in the interval. *See infra* note 68 and accompanying text.

⁵⁸ The conference report on the budget resolution, H. Rep. 108-498 (2004), was agreed to by the House on May 19, but has not yet been considered by the Senate. *See* Heniff, *Congressional Budget Actions in 2004*, at 1 (Cong. Res. Serv., May 25, 2004).

⁵⁹ *See* S. Con. Res. 95, 108th Cong., § 408 (2004); Heniff, *supra* note 58, at 10.

⁶⁰ Garrett, *supra* note 54, at 727.

impasse is unlikely to have dire consequences because other budget-related legislation can continue to move forward.⁶¹ Indeed, the most likely outcome may be to forestall enactment of any significant tax changes in 2004, since the reconciliation process can be triggered only by adoption of a concurrent budget resolution.⁶²

IV. In Search of Simplification

In analyzing the Administration's fiscal year 2005 proposal, the Joint Committee on Taxation summarizes two general arguments in favor of making the 2001 and 2003 tax cuts permanent, noting that "it was never anticipated that the sunset [provisions] actually would be allowed to take effect," and that "eliminating them promptly would promote stability and rationality in the tax law."⁶³ To be sure, virtually no one expects to see the estate tax (as it existed before the 2001 Act) spring back into force in 2011, but it does not follow that permanent repeal has become any more attractive or affordable in 2004 than it was when the sunset provision was included in the 2001 Act.⁶⁴ The 2001 Act reflected a stalemate between those who sought permanent estate tax repeal and those who sought to retain the estate tax with an immediate increase in the exemption.⁶⁵ Because neither group could muster sufficient

⁶¹ See Schick, *supra* note 30, at 106 (noting that in 1998 "[t]he lack of a budget resolution was hardly noticed").

⁶² This outcome may come as a relief to opponents of large-scale tax cuts. See Kogan, *Fiscal Discipline Likely to Be Greater This Year Without a New Congressional Budget Resolution than With One* (Center on Budget and Policy Priorities, April 27, 2004).

⁶³ Joint Committee Description, *supra* note 1, at 11.

⁶⁴ See *id.* (acknowledging the argument that "certain provisions of [the 2001 and 2003 Acts] would not have been enacted at all, or would not have been phased in or phased out in the same manner, if the sunset provisions had not been included").

⁶⁵ Cf. H.R. Rep. No. 107-37, at 194 (2001) (noting alternative proposal to retain estate tax with immediate increase in exemption to \$2,000,000).

votes to achieve a decisive victory, the controversy was in effect left open to be resolved at a later date. As the sunset date draws nearer and the costs of estate tax repeal become clearer, there may be increased political pressure to reach a stable, long-term compromise short of permanent repeal.

The argument that sunset repeal would promote “stability and rationality” in the tax law is closely related to claims concerning complexity under the 2001 Act. Proponents of repeal view the sunset provision itself as a source of complexity because it forces taxpayers to plan for alternative sets of legal rules, depending on whether death occurs in 2010 (during the one-year estate tax repeal) or in a later year (when the estate tax may have been reinstated).⁶⁶ However, the sunset provision reflects a calculated fiscal and political gamble undertaken by opponents of the estate tax who insisted on full repeal, even if only for a single year, instead of pursuing a more modest tax cut that might have garnered sufficient support to be made permanent at the outset.⁶⁷ The instability and complexity flowing from the rapid sequence of repeal and reinstatement was just as evident in 2001 as it is today, and could be resolved quickly by a compromise solution involving reform rather than repeal of the estate tax.

Indeed, repealing the sunset provision might give rise to several unexpected problems. For example, sunset repeal would subject property passing at death to new and untried carryover basis rules that exhibit serious conceptual and practical shortcomings. The carryover basis system enacted in the 2001 Act would probably raise very little revenue, due to large statutory exemptions and the

⁶⁶ See Joint Committee Description, *supra* note 1, at 11 (discussing “cliff effect” and noting that, “[i]n addition to the complexity created by the need to plan for the sunset, uncertainty about the timing and details of how the sunset might be eliminated arguably creates further complexity”).

⁶⁷ See Gale & Orszag, *supra* note 23, at 1279 (noting that, within the reconciliation process, the Administration could have sought “a smaller tax cut within the 10-year budget window in exchange for making the tax cut permanent,” but refused to do so).

possibility of indefinite tax deferral for families with large accumulations of dynastic wealth. At the same time, the requirements of maintaining basis records (possibly over many generations), allocating exemptions, and filing information returns would impose burdens comparable to those of the estate tax.⁶⁸ Furthermore, sunset repeal would leave in place a stand-alone gift tax that would perpetuate many of the most troublesome aspects of the estate tax while creating a perverse “lock-in” effect and in all likelihood raising negligible revenue.⁶⁹ Given these shortcomings, it seems quite possible that sunset repeal would achieve less in the way of simplification and stability than reform of the existing estate tax. While it is hardly surprising that the Administration’s proposal fails to address the disadvantages of sunset repeal, it is disappointing that the Joint Committee does not even mention carryover basis or the stand-alone gift tax in its analysis of “complexity issues.”⁷⁰

A somewhat different aspect of complexity arises from the extended phase-in period of the tax cuts under the 2001 Act.⁷¹ The scheduled repeal of the estate tax in 2010 follows a series of incremental reductions in the top marginal rate and increases in the estate tax exemption.⁷² For many taxpayers who use traditional formula clauses to allocate property between taxable bequests sheltered

⁶⁸ Burke & McCouch, *supra* note 3, at 199. For a discussion of carryover basis under the 2001 Act, see *id.* at 201-23.

⁶⁹ See *id.* at 223-28.

⁷⁰ See Joint Committee Description, *supra* note 1, at 11-12.

⁷¹ See *id.* at 12 (acknowledging that “discontinuities” during the phase-in period give rise to “uncertainty and complexity”).

⁷² Under the 2001 Act, the top marginal tax rate falls by one percentage point each year until 2007, when it reaches 45%. The exemption rose to \$1.5 million in 2004 and is scheduled to rise further to \$2 million in 2006 and \$3.5 million in 2009. Accordingly, beginning in 2007, the estate tax will be imposed at a flat 45% rate on transfers in excess of the exemption amount. See I.R.C. §§ 2001(c)(2), 2010(c). In contrast, the gift tax exemption remains frozen at \$1 million, resulting in a gap between the gift and estate tax exemptions beginning in 2004. See I.R.C. § 2505(a)(1).

by the unified credit and deductible marital or charitable bequests, the allocation may shift in dramatic and unintended ways depending on whether the taxpayer's death occurs in 2004, 2006, 2009 or 2010. The effects will be especially disruptive in the case of moderate estates under \$5 million. At a broader level, the phase-out of the federal credit for state death taxes⁷³ has already effectively put an end to the largely uniform system of state "pick-up" taxes and shifted substantial estate tax revenue from the states to the federal government. Several states have already moved to adopt independent estate taxes with different rates and exemptions, resulting in new complexity and planning burdens for taxpayers.⁷⁴ Of course, the Administration's proposal to repeal the sunset provision would do nothing to ameliorate the complexity and instability of the tax law during the phase-in period. The awkward sequence of phase-ins and phase-outs flows directly from the decision taken in 2001 to minimize the apparent revenue costs of the tax cuts by backloading them toward the far end of the 10-year budget window. The most obvious way to make the tax law simpler and more stable would be the prompt enactment of a durable compromise agreement concerning the future of the tax cuts.

With respect to the estate tax, a plausible compromise solution would restore the estate tax with somewhat lower rates and a higher exemption than under present law. Clearly the tax could be more narrowly targeted and still raise substantial revenue.⁷⁵ For example, one recent study estimates that in

⁷³ The credit will be fully phased out and replaced with a deduction beginning in 2005. *See* I.R.C. §§ 2011(b)(2), (g), 2058.

⁷⁴ *See* Michael, *State Responses to EGTRRA Estate Tax Changes*, Tax Notes 1023 (May 24, 2004); Steiner, *Coping With the Decoupling of State Estate Taxes After EGTRRA*, 30 Est. Plan. 167 (2003); Conway & Rork, *Recent Developments in State 'Death' Taxes*, State Tax Notes 1041 (March 25, 2002).

⁷⁵ *See* Burke & McCouch, *supra* note 3, at 200-01 (noting that in 2000, "raising the estate tax exemption to \$5,000,000 would have eliminated estate tax liability for all but the wealthiest 3621 decedents – 0.0015% of total deaths – while preserving more than half the revenue generated by the current estate tax").

2014 a scaled-back estate tax would raise annual revenue ranging from \$30 to \$46 billion, depending on the applicable rates and exemptions.⁷⁶ Proposals along these lines have surfaced repeatedly in recent years,⁷⁷ but have met fierce resistance from advocates pressing for full estate tax repeal. The reason for the intransigent posture of the hard-core repealers is not far to seek. Although estate tax repeal would benefit only a small number of very wealthy families, the repealers' political influence depends on their ability to portray the so-called "death tax" as a serious threat to the well-being of family farms, small businesses, middle-class families, and the nation as a whole.⁷⁸ Proposals to raise the exemption would leave only the extremely wealthy subject to estate tax and would undermine political support for full repeal.⁷⁹ By rejecting a compromise solution, the repealers keep the estate tax controversy alive and maintain political pressure for full repeal. Moreover, by deferring repeal until the end of an extended phase-in period, the repealers ensure that they can take advantage of continuing uncertainty and

⁷⁶ See Aaron et al., Meeting the Revenue Challenge, in *Restoring Fiscal Sanity: How to Balance the Budget* 111, 115 (Rivlin & Sawhill eds., 2004). The study finds that in 2014 an estate tax with a top marginal rate of 50% and a \$2.5 million exemption would raise annual revenue of around \$46 billion; with a top rate of 45% and a \$3.5 million exemption, annual revenue would be around \$38 billion; and with a top rate of 35% and a \$5 million exemption, annual revenue would be around \$30 billion. *Id.*

⁷⁷ See, e.g., H.R. Rep. No. 107-37, at 194 (2001) (describing proposal to retain estate tax with immediate increase in exemption to \$2,000,000); H.R. 5008, 107th Cong. (2002) (proposing retention of estate tax with \$3.5 million exemption and 50% top marginal rate). In March 2004, Charles Grassley, chairman of the Senate Finance Committee indicated interest in pursuing "a compromise" with a "sizeable exemption" of "probably \$5 million" and a "fairly reasonable tax rate" as the approach with "the most chance of success." Grassley Suggests He Will Not Move Bill to Speed Up Repeal of Estate Tax, Daily Tax Report G-7 (March 10, 2004).

⁷⁸ For an interesting account of the origins and tactics of the campaign for estate tax repeal, see Johnston, *Perfectly Legal* 71-91 (2003).

⁷⁹ See *id.* at 81 (noting Republican political consultant Frank Luntz's view that if the exemption were raised high enough "the movement to repeal [the estate tax] would collapse because it would affect so few families").

instability to extract contributions from wealthy political donors.⁸⁰

V. Conclusion

The reconciliation process has shaped the process and outcomes of tax legislation in unexpected ways.⁸¹ During the 1980's and 1990's, reconciliation facilitated enactment of deficit-reduction measures that might otherwise have been unattainable, but recently some observers have begun to ask whether reconciliation itself has become part of the problem rather than the solution.⁸² The reconciliation process has long been criticized for exacerbating the complexity of tax legislation, partly because the process is extremely compressed and does not "lend itself to orderly and deliberate consideration" of legislative proposals.⁸³ Moreover, the reconciliation process has contributed to a shift of power from committees and staff to party leaders and staff who tend to be "more political and less expert" in matters of substantive tax policy.⁸⁴

With the return of deficits as far as the eye can see, the reconciliation process might revert to its

⁸⁰ See *id.* at 78 (noting that delayed repeal means "years of opportunities to raise money from donors who could see the abyss coming and would be eager to speed up the effective date of repeal"). For an illuminating discussion of the economic theory of regulation and its application to tax legislation, see Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. Pa. L. Rev. 1 (1990).

⁸¹ See Garrett, *supra* note 54, at 718 (noting that "the framers of the 1974 Act did not foresee the rise of reconciliation acts" and that reconciliation is attractive because of its "sheer effectiveness"); Tobin, *supra* note 33, at 144 ("No one imagined that [reconciliation] would become a method for circumventing the filibuster and for making major substantive policy changes with extremely limited debate.").

⁸² See Tobin, *supra* note 33, at 117 (commenting that the Congressional Budget Act "is understood by almost no one" and "can be interpreted and manipulated by the majority to its political advantage"); *id.* at 144-45 (concluding that the reconciliation process should be repealed or substantially reformed and simplified).

⁸³ McLure, *The Budget Process and Tax Simplification/Complication*, 45 Tax L. Rev. 25, 79 (1989); see also Schick, *supra* note 30, at 128 (noting that the Senate's 20-hour limit on debate means that in some years the debate on reconciliation bills "amounts to less than one minute per page").

⁸⁴ Garrett, *supra* note 54, at 730.

original function of expediting the passage of deficit-reduction legislation. Alternatively, the Byrd rule might be modified or eliminated if a sufficiently powerful and organized majority determines that the rule no longer serves their interests.⁸⁵ The sunset provisions themselves are an outgrowth of an increasingly partisan budget process coupled with the absence of a stable supermajority capable of overriding the Byrd rule.⁸⁶ In sum, the growing use of sunset provisions in recent years is both a symptom of underlying problems in the budget process and a cause of instability and complexity in tax legislation. Whether the tax cuts enacted in 2001 and 2003 will become permanent remains to be seen. What is already clear, however, is that the Administration's proposal to repeal the sunset provisions would impose enormous costs on future generations of taxpayers.⁸⁷

⁸⁵ See Gilmour, *supra* note 50, at 230 (“Congress determines its own rules, and it is fully capable of eliminating procedures and arrangements that do not serve its members’ interests.”). *Cf.* Evans, *supra* note 29, at 415 (noting that changes to the Byrd rule would most likely be linked to “the broader question of whether reconciliation should be used for tax cuts”).

⁸⁶ See Tobin, *supra* note 33, at 138 (noting that “the minority, which took almost no part in the reconciliation process, has almost no opportunity to debate the measure and offer amendments”).

⁸⁷ See Gale & Potter, *supra* note 55, at 133 (describing 2001 tax cuts as “not fiscally sustainable” if made permanent).